No. 90-1029

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

EASTMAN KODAK COMPANY,
Petitioner,

v.

IMAGE TECHNICAL SERVICE, INC., *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF OF AMICUS CURIAE MOTOR VEHICLE MANUFACTURERS ASSOCIATION OF THE UNITED STATES, INC. AND THE ASSOCIATION OF INTERNATIONAL AUTOMOBILE MANUFACTURERS, INC. AS AMICUS CURIAE IN SUPPORT OF PETITIONER

Of Counsel

WILLIAM H. CRABTREE
7430 Second Avenue
Suite 300
Detroit, Michigan 48202

CHARLES H. LOCKWOOD, II
1001 19th Street North
Suite 1200
Arlington, Virginia 22209

* Counsel of Record

THOMAS B. LEARY *
HOGAN & HARTSON
555 Thirteenth Street, N.W.
Washington, D.C. 20004
(202) 637-5662

Counsel for Amicus Curiae The Motor Vehicle Manufacturers Association of the United States, Inc. and The Association of International Automobile Manufacturers, Inc.

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PRELIMINARY STATEMENT

With consent of the parties, the Motor Vehicle Manufacturers Association of the United States, Inc. ("MVMA") and the Association of International Automobile Manufacturers, Inc. ("AIAM") submit this brief *amicus curiae*. The brief will argue for reversal of the decision below because of the serious adverse consequences of a holding that a manufacturer without market power over the goods it sells can have market power over the replacement parts for those goods. This brief endorses,

but will not simply repeat or summarize, the discussion of this issue contained in the *Brief for the United States as Amicus Curiae* (May 22, 1991) and the *Petition for Writ of Certiorari* (December 20, 1990). The brief will rather focus on the disastrous consequences of any such rule for the members of MVMA and AIAM, and for the ultimate purchasers of the automobiles they manufacture.

THE INTEREST OF AMICUS CURIAE AND SUMMARY OF ARGUMENT

From time to time, both MVMA and AIAM participate as *amicus* in litigation that raises issues of substantial importance to their members.

MVMA is a trade association of United States Motor Vehicle Manufacturers. Its members are Chrysler Corporation, Ford Motor Company, General Motors Corporation, Honda of America Mfg., Inc., Navistar International Transportation Corp., PACCAR, INC. and Volvo North America Corporation.

AIAM is a trade association of manufacturers, manufacturer authorized importers, and distributors of motor vehicles manufactured for sale in the United States, whose members and associate members include American Honda Motor Co., Inc., American Suzuki Motor Corporation, BMW of North America, Inc., Daihatsu Motor Co., Ltd., Fiat Auto U.S.A., Inc., Hyundai Motor America, Isuzu Motors America, Inc., Jaguar Cars Inc., Mazda Motor of America, Inc., Mitsubishi Motor Sales of America, Inc., Nissan North America, Inc., Peugeot Motors of America, Inc., Porsche Cars North America, Inc., Rolls-Royce Motor Cars, Inc., Rover Group USA, Inc., Saab Cars USA, Inc., Subaru of America, Inc., Toyota Motor Sales, U.S.A., Inc., Volkswagen of America, Inc., Volvo North America Corporation and Yugo America, Inc.

This Court may take notice of some undisputed and widely reported facts about the motor vehicle industry

in the United States. The industry is intensely competitive. The three largest American manufacturers (General Motors, Ford and Chrysler), which once accounted for over 90% of new passenger car sales, now have a sales share of only 65%—primarily because of increased competition from foreign car manufacturers. Price competition is so keen that not one of the three largest American manufacturers reportedly makes any profit on its vehicle operations in North America today. In these circumstances, no single U.S. manufacturer realistically could be said to have market power.

All automobile manufacturers in the U.S. (and elsewhere) produce highly complex machines that each contain approximately 13,000 different parts. Each manufacturer produces a variety of different models, and a substantial percentage of the parts in any vehicle are unique to the particular manufacturer or model. Few parts in a Ford Taurus, for example, are common to a Ford Thunderbird, and a far smaller number could be used in a Chevrolet.

Each manufacturer, of course, must supply replacements for virtually all the parts in every single different model. There is little replacement demand for many of these parts, they may be unprofitable even for the auto manufacturer to stock and distribute, and therefore there is very little incentive for other parts suppliers to carry them. These other suppliers naturally want to focus on the replacement parts with the largest turnover for the products of large volume producers.

As a result of these natural market forces, all auto manufacturers will inevitably have a very large share of replacement parts sales for their own vehicles. Indeed, the smaller the sales of a particular vehicle, the higher the manufacturers' parts share is likely to be because not many suppliers will be motivated to compete for such a low-volume demand. If a large "market share" in re-

placement parts for particuar automobiles were evidence of market power or monopoly, then the MVMA and AIAM member companies apparently have such power in many different markets. And, paradoxically, the apparent power may be greatest for the companies which sell the fewest vehicles.

Any company which arguably possesses power in some "market" faces serious litigation risks in the everyday operation of its business, even though the asserted power is wholly illusory. The company is particularly vulnerable to claims that it has monopolized, attempted to monopolize, or imposed tying requirements. Under threat of litigation, the company may be compelled to adopt policies that are inefficient and that will ultimately cause competitive harm. For these reasons, MVMA and its members are seriously concerned about the market test sanctioned by the Ninth Circuit's majority decision in this case.

ARGUMENT

I. THE MARKET DEFINITION ADOPTED BY THE COURT BELOW IS UNREALISTIC AND LEADS TO PERVERSE RESULTS.

A. There Is No Separate Economic Market for Replacement Parts.

The purchasers of automobiles and trucks, like the purchasers of Kodak copiers, know that replacement parts and service will be required from time to time, and they take this into account when they make their purchase decisions. The trend toward increasingly expansive warranty coverage for new vehicles provides one vivid demonstration that the costs of ongoing maintenance and repair are an important element in the competitive struggle for new-vehicle sales.

It is also noteworthy that the U.S. Bureau of Labor Statistics recognizes repair services as an inherent part of a vehicle's content. When the Bureau calculates the

value of quality improvements (or reductions) for its producer and consumer price indices, it gives weight to an improvement (or reduction) in consumer warranties just as it would to a change in any other component part.

Moreover, vehicle manufacturers cannot treat parts and service as separate "markets," which they may enter or exit at will. In order to sell new vehicles (and in some cases to comply with the law), manufacturers have to make available a large inventory of spare parts and provide ready access to service operations nationwide—even though a freestanding enterprise would not find it economical to provide this broad coverage.

It is unrealistic to suppose that automobile manufacturers could exercise any hypothetical market power by raising the prices of replacement parts or service; if they tried to do so, many consumers would perceive it as an increase in the price of new vehicles and the manufacturers would lose sales. The competitive pressures on automobile manufacturers are thus similar to those faced by Kodak.[1] These competitive realities have been concisely described in the dissenting opinion below,[2] and in the briefs already filed by Petitioner and the Department of Justice; this brief will not replow the same ground.

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[1] It is likely that the average vehicle buyer is not as sophisticated about maintenance costs as the average buyer of Kodak equipment, but this only affects the speed with which sales will be lost, not the basic trend.

[2] The following passage in the dissent is also applicable to the vehicle industry:

> Kodak may either price parts competitively and maintain its interbrand market share, or it may price parts supercompetitively—yielding a short-term gain but over the long term destroying its share of the interbrand market. In either case Kodak is not harming competition: if it adopts the latter strategy, competitive forces will exact a heavy toll in the interbrand market, and profits gained from the short-term parts mark-ups will quickly be eclipsed. [Pet. App. 23A]

One point, however, should be re-emphasized. The Ninth Circuit majority refused to apply economic logic and common sense because it believed that some unspecified "market imperfections" could "keep economic theories about how consumers will act from mirroring reality." (Pet. App. 10A) The suggestion is that courts should be somehow wary of economic theory when considering summary judgment motions. This reluctance is flatly contrary to the approach in *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), where this Court applied commonsense economic theory in order to avoid a jury verdict based on unrealistic assumptions.

> . . . if the factual context renders [plaintiff's] claim implausible—if the claim is one that simply makes no economic sense—[plaintiffs] must come forward with more persuasive evidence than would otherwise be necessary. [475 U.S. at 587].

Indeed, it is necessary to apply some economic theory or model in virtually any antitrust case in order to arrive at a rational result. Private antitrust cases, inevitably, are brought by plaintiffs who claim damage from some economic activity. But plaintiffs can be harmed by activity that is pro-competitive as well as by activity that is anticompetitive, and it is difficult to distinguish between the two without some economic theory about how the competitive system is supposed to work. The impact on the competitive process of particular conduct—like a merger, a resale restriction or an aggressive price reduction—can rarely be determined in any antitrust case without consideration of economic theory. In fact, the *per se* condemnation of tying arrangements that is invoked by the opinion below (Pet. App. 4A), implicitly rests on the global economic assumption that these arrangements are almost invariably harmful to competition. The court below did not reject theory out of a preference for facts; what it did was reject a sound theory in favor of one that increasingly is recognized as unsound. *See Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 32 (1984) (concurring opinion).

It does not make economic sense to find "market power" based on sales shares for replacement parts and services, and the majority opinion below should not have closed its eyes to the economic reality that the opinion itself recognized: namely, the fact that "equipment purchasers would turn to one of Kodak's competitors' if Kodak tied supracompetitively priced parts or service directly to equipment." (Pet. App. 9A)

Courts have repeatedly held that it is wrong to define a single manufacturer's brand as a separate market. *See United States v. E. I. duPont de Nemours & Co.*, 351 U.S. 377, 393 (1956):

> Thus one can theorize that we have monopolistic competition in every nonstandardized commodity with each manufacturer having power over the price and production of his own product. However, this power that, let us say, automobile or soft-drink manufacturers have over their trademarked products is not the power that makes an illegal monopoly. Illegal power must be appraised in terms of the competitive market for the product.

See also, e.g., International Logistics Group, Ltd. v. Chrysler Corp., 884 F.2d 904, 908 (6th Cir. 1989), *cert. denied*, 110 S. Ct. 1783 (1990) ("a manufacturer cannot be charged with antitrust violations if it monopolizes its own brand"). Moreover, if a manufacturer has no market power over its end product, it cannot "monopolize the market for each unique component that goes into the product." *General Business Systems v. North American Philips Corp.*, 699 F.2d 965, 975 (9th Cir. 1983); *accord Grappone, Inc. v. Subaru of New England, Inc.*, 858 F.2d 792, 799 (1st Cir. 1988) (no significant anticompetitive effect from restraint in "Subaru part" replacement market).

It is true, of course, that once consumers have purchased a vehicle of a particular brand, their options for parts replacement or service may be relatively more limited. But, as pointed out by the dissenting judge below in the analogous case:

> If some Kodak owners are unwilling to scrap their copiers and buy new ones from other manufacturers, Kodak will gain short-run profits from the sale of parts. However, as new buyers switch brands, Kodak will lose market share in the sales of new copiers, to its long-term disadvantage. [Pet. App. 21A].

In fact, since the sales of replacement parts and service are ultimately dependent on sales of new products, any attempt to exploit "locked-in" buyers would eventually redue sales of parts and service as well.

This Court actually addressed this issue in the comparable circumstances presented by the *Jefferson Parish* case. People who have already purchased a particular vehicle are analogous to surgical patients who have already checked into a particular hospital. The choices of these patients presumably were materially constrained by an exclusive contract that the hospital had with anesthesiologists. In *Jefferson Parish*, however, this Court appropriately analyzed the arrangement from the standpoint of patients who had *not yet* decided on a hospital:

> Only if patients are forced to purchase Roux's services as a result of the hospital's market power would the arrangement have anticompetitive consequences. If no forcing is present, patients are free to enter a competing hospital and to use another anesthesiologist instead of Roux. [466 U.S. at 25].

The market power test applied by the Ninth Circuit majority is not sanctioned either by prior authority or by economic rationality. This brief will now provide specific illustrations of the perverse effect that this test would have in antitrust litigation involving the automobile industry.

B. Claims Based on a Refusal to Deal.

A competitive business enterprise normally has the freedom to select its own customers. *United States v. Colgate & Co.*, 250 U.S. 300 (1919). The immediate customers of vehicle manufacturers are their franchised dealers, and these manufacturers take extraordinary care in the selection of dealers and ongoing supervision of their performance. This Court has recognized that there are "legitimate reason(s) for a manufacturer's desire to exert control over the manner in which his products are sold and serviced." *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 55 n. 23 (1977). It is no coincidence that the members of MVMA and AIAM, like other manufacturers of complex equipment with ongoing service requirements, tend to have selective distribution systems.

There is, however, a body of antitrust authority which holds that a producer with "monopoly power" or one with access to an "essential facility" does not have the same freedom to select its customers. *E.g., Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985); *MCI Communications Corp. v. American Telephone & Telegraph Co.*, 708 F.2d 1081 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983). If a manufacturer's inevitably high "market share" in the sale of its own replacement parts is taken as an indication of monopoly power, then manufacturers may be subject to antitrust claims whenever they attempt to limit the distribution of replacement parts.

There are a number of legitimate reasons for a manufacturer's refusal to sell replacement parts to all comers. The most obvious is the added administrative cost of dealing directly with large numbers of relatively small customers, but there are other considerations that are particularly important to manufacturers of complex consumer products.

If vehicle service and repair are performed incompetently, for example, consumers will assign some of the

blame to the manufacturer. It is frequently hard for consumers to distinguish between the effects of incompetent repair and incompetent manufacture, and even if repair can be pinpointed as the problem consumers may think that the manufacturers should have exercised greater supervision over repair outlets. Ongoing supervision of independent service facilities may be totally impractical and/or prohibitively expensive, however, and therefore the only practical way to address a serious potential threat to a manufacturer's goodwill may be to limit initially the distribution of replacement parts. This does provide some limited measure of quality control even though dealers may resell the parts to others, and the manufacture's goodwill is less implicated in the performance of "non-franchised" repair shops.

Manufacturers may also have a perfectly legitimate incentive to protect the profitability of their dealers who sell the vehicles themselves and who must be able to fulfill a broad spectrum of service responsibilities. These dealers are required to stock a full complement of parts, the slow-moving and the fast-moving. They have to invest in expensive facilities to maintain this extensive parts inventory, as well as to perform repairs that are out of the ordinary. Unaffiliated service facilities, which do not have corresponding obligations, may therefore have an oportunity to undercut the competitive postition of franchised dealers by concentrating on the most lucrative aftermarket opportunities and "free riding" or "skimming the cream." The *Sylvania* opinion recognized, in analogous circumstances, that a manufacturer may legitimately take actions to protect its dealers from competition of this kind.

It is not a sufficient answer to say that a manufacturer, accused of exploiting a "monopoly" over its own replacement parts, can always prove a business justification for its refusal to sell to a particular antitrust plaintiff. Antitrust litigation is incredibly time-consuming and expen-

sive,[3] and the burden of proof in a rule-of-reason case is particularly important. It is wrong to impose these burdens on a hard-pressed industry, to the ultimate detriment of consumers, as a result of artificial market tests that do not reflect economic reality.

C. Claims of Attempted Monopolization.

The members of MVMA and AIAM do not insist on the use of their own replacement parts for all aftermarket services. They do, however, require their dealers to stock a supply of their own "genuine" parts and generally to use such parts when making warranty repairs (which the manufacturers themselves pay for). Moreover, since a great many substandard parts of all kinds are offered for sale in this country, the vehicle manufacturers believe it is imperative that dealers be cautioned against the use of substandard parts.

Here again, the concept that a manufacturer can exert monopoly power over the sale of its own replacement parts could make it potentially hazardous for a manufacturer to take these prudent steps to protect its own goodwill and guard against the installation of unsatisfactory (and perhaps unsafe) parts in its vehicles on the road. A manufacturer with an already high "market share" for replacement parts may be vulnerable to claims of attempted monopolization if it takes competitive action that will maintain or increase that market share. A specific intent to monopolize may be more readily inferred and, of course, the "dangerous probability" of success

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[3] *In re General Motors Corp.*, 99 F.T.C. 464 (1982) involved, *inter alia*, a claim that GM had a monopoly over the manufacture of so-called "crash parts," like doors and fenders that are likely to be damaged in accidents, and that therefore GM should make these parts directly available to independent body shops. The company ultimately prevailed on business justification grounds, but the case was litigated for over six years and cost millions to defend and to prosecute.

could easily be demonstrated. *See Swift & Co. v. United States*, 196 U.S. 375, 396 (1905).

Predatory pricing claims will similarly be facilitated. As mentioned above, a vehicle manufacturer must supply replacements for each of the thousands of parts in its vehicles, even though it is very expensive to do so. For many of the parts there may be no competition at all (at least until a bank of used parts becomes available), and a manufacturer's competitive price responses may therefore be selective and targeted rather than across the board. If shares of replacement-part sales are viewed in isolation, the high shares of vehicle manufacturers make them vulnerable to predatory-pricing claims. And these claims would be hard to defend with one of the standard cost/price tests because the costs of any particular replacement part may be extraordinarily difficult to calculate.

A vehicle manufacturer that has the burden of producing and distributing a full range of parts may well have to price below the fully allocated cost of some parts in order to meet the competition of an outside parts supplier that does not undertake the burden of supplying the full range. Alternatively, if the manufacturer elects to set prices for the fastest-moving parts above those of the competition, it will steadily lose sales of these parts. Moreover, under the perverse logic of the opinion below, the existence of some sales at a "premium" price would provide further evidence of monopoly power in the market for parts.[4] There is something seriously wrong with a market test that poses these kinds of impossible choices.

D. Tying Claims.

In the instant case, a particular set of facts was pleaded alternatively under Section 1 of the Sherman Act (tying agreements) and Section 2 of the Sherman Act (monopo-

[4] The majority below relied on evidence that in some cases Kodak charged more for service than the plaintiffs did. (Pet. App. 10A-11A).

lization). The common factor in each count was the claim that "market power" or "monopoly" was demonstrated by a high sales share in replacement parts. It was then easy to argue that the defendant attempted to extend its "market power" over replacement parts (the tying product) into the market for service (the tied product).[5] The same market-share statistics would support an argument that the defendant had a "monopoly" of its replacement parts, and therefore was not free to select its own customers.

Similar theories are available in actions against MVMA and AIAM members. Consider a claim that a standard new-vehicle warranty ties vehicles, parts and service together. If it is claimed that vehicles are the tying product, a plaintiff would find it hard to prove the requisite market power—and in any event, the instant decision does not directly affect the result. But this decision could encourage plaintiffs to claim that parts are the tying product. The argument would be that customers who want the replacement parts to which they are entitled under warranty have to take the dealer warranty service as well.

Alternatively, it could be argued that the only way to get some replacement parts from manufacturers (an area where they assertedly have "market power") is to get a franchise to sell vehicles, and in this case vehicles would be the tied product. Ridiculous as it may seem, an analogous theory was upheld in the *Sterling Electric* case.[6]

These arguments intuitively seem artificial, but potential plaintiffs will be encouraged to advance artificial tying theories, irrespective of economic reality, so long as

[5] The plaintiff apparently made the alternative claim that Kodak attempted to tie parts to service, which seemed only to add to the court's confusion. (See Pet. App. 5A).

[6] *Parts & Electric Motors, Inc. v. Sterling Electric, Inc.*, 866 F.2d 228 (7th Cir. 1988), *cert. denied*, 110 S. Ct. 141 (1989).

courts continue to characterize tying arrangements as *per se* offenses. There is substantial support for a revision of that view, as demonstrated by the split opinion in *Jefferson Parish*. This controversy is beyond the scope of this brief, but it can be said that if tying arrangements continue to be deemed *per se* illegal an intelligent application of market-power tests is the most promising way to screen out spurious antitrust claims. Alternatively, if this Court were to decide that tie-in cases should be judged under the rule of reason, an intelligent application of market tests would also be necessary to arrive at sensible results.

CONCLUSION

For these reasons, the members of MVMA and AIAM are seriously concerned about the majority opinion of the Ninth Circuit, and urge this Court to reverse it.

These members obviously do not claim that they should be absolved from the burdens of antitrust litigation. But if antitrust litigation is grounded in theories that bear no relation to economic reality, then there is no conceivable public benefit to justify those burdens—and consumers ultimately will pay the price.

Respectfully submitted,

Of Counsel

WILLIAM H. CRABTREE
7430 Second Avenue
Suite 300
Detroit, Michigan 48202

CHARLES H. LOCKWOOD, II
1001 19th Street North
Suite 1200
Arlington, Virginia 22209

* Counsel of Record

THOMAS B. LEARY *
HOGAN & HARTSON
555 Thirteenth Street, N.W.
Washington, D.C. 20004
(202) 637-5662

Counsel for Amicus Curiae The Motor Vehicle Manufacturers Association of the United States, Inc. and The Association of International Automobile Manufacturers, Inc.